OnPoint
Dechert LLP

January 2014

A Legal Update from Dechert LLP

Volcker Rule Regulations Issued: Understanding the Practical Implications for U.S. and Foreign Banking Entities, Funds and Securitization Vehicles

The Volcker Rule ("Volcker Rule" or "Rule") is intended to limit risks to the financial system that Congress believes may be created by (i) proprietary trading operations of insured depository institutions, foreign banking entities with certain U.S. operations, and the affiliates of the foregoing entities (collectively, "banking entities") through a set of "Trading Restrictions," and (ii) investments and certain relationships between banking entities and private equity and hedge funds (which are referred to as "covered funds") through a set of "Fund Restrictions."[1]

The Volcker Rule itself comprises only 11 pages of a nearly 850-page law. It has been, however, one of the most controversial parts of the Dodd-Frank Act ("DFA"), as demonstrated by the long delays, thousands of comments and arduous path taken by the five federal regulatory agencies – the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") (together, the "Agencies") – to agree on final implementing regulations.[2]

Congress had expected that the final Volcker Rule regulations would be issued by October 2011 and become effective on July 21, 2012. In April 2012, the FRB, which is given authority to issue rules and make determinations regarding conformance periods for activities and investments subject to the Volcker Rule, clarified that banking entities would generally have two years from July 21, 2012 to conform to the requirements of the Volcker Rule. During the conformance period, banking entities were expected to engage in good faith efforts to achieve conformance of all activities and investments by no later than the end of that period.

The rulemaking process culminated on December 10, 2013, when each of the Agencies acted to approve a final rule implementing the Volcker Rule ("Regulations" or "final rule"). While the FRB's Board of Governors and FDIC's Board of Directors unanimously approved, and the Comptroller of the Currency acted to approve, the Regulations, the SEC's Commissioners voted 3-2, and the CFTC's Commissioners voted 3-1 to approve the Regulations. For a discussion of key changes and developments regarding the Regulations since the proposed rule was issued, see our *Dechert OnPoint, U.S. Agencies Issue Final Regulations Implementing the Volcker Rule: A Summary of Key Developments*.

The following discussion analyzes and dissects the Volcker Rule from the perspective of banking entities that are attempting to answer questions about how it may apply and impact their business.

---

1 This OnPoint is based on the currently available versions of the Regulations and the preambles thereto and other Agency statements related to the Regulations. Certain matters discussed herein may be subject to change based on subsequent Agency developments and the final version of the Regulations, as published in the Federal Register.

2 The Agencies asked nearly 400 questions in the proposing release in regard to their proposed rule. They received over 18,000 comment letters, including more than 600 unique comment letters.

TABLE OF CONTENTS

SCOPE 3

When is the Volcker Rule effective? 3

What activities does the Volcker Rule restrict? 3

Who is subject to the Regulations? 3

What entities are excluded from banking entity status? 4

TRADING RESTRICTIONS 5

What Trading Restrictions do the Regulations impose? 5

What qualifies as a "trading account"? 5

What is a "financial instrument"? 7

What accounts are excluded from proprietary trading? 8

What proprietary trading activities are permitted by the Regulations? 9

What other restrictions apply to permitted proprietary trading and potentially override the authority to engage in permitted proprietary trading activities? 14

FUND RESTRICTIONS 17

Scope 17

What prohibitions and restrictions will apply to covered fund activities? 17

What activities qualify as non-principal activities that are excluded from the Fund Restrictions on sponsorship and investment? 17

What is a "covered fund"? 17

Who is considered to be a sponsor of a covered fund? 19

What constitutes an ownership interest in a covered fund? 19

What types of entities are excluded from treatment as covered funds? 21

Permitted Customer Covered Funds and ABS Covered Funds 27

Under what circumstances may a banking entity sponsor or invest in a covered fund? 27

Other Permitted Covered Funds 30

Fund Transaction Provisions 32

What restrictions apply to transitions between a covered fund and a banking entity that sponsors, invests in, or provides investment advisory or commodity trading advisory services to the covered fund? 32

Overriding Prohibitions on Permissible Covered Fund Activities 33

What other limitations apply to permitted covered fund activities? 33

COMPLIANCE PROGRAM REQUIREMENTS 33

What compliance-related obligations do the Regulations impose on banking entities? 33

ENFORCEMENT 35

SCOPE

Q. When is the Volcker Rule effective?

A. April 1, 2014, with a conformance period that expires on July 21, 2015.

On December 10, 2013, in connection with the Agencies' issuance of the Regulations, the FRB exercised its authority to extend the conformance period for one year until July 21, 2015. The FRB has advised banking entities that:

- they will be expected to develop a conformance plan for all activities and investments;
- banking entities that have stand-alone proprietary trading operations are expected to promptly terminate or divest those operations;
- banking entities should ***not*** expand activities or make investments during the conformance period with an expectation that additional time to conform those activities or investments will be granted; and
- the extension does not apply to data reporting and recordkeeping requirements applicable under the Regulations to certain banking entities with significant trading activities.

Q. What activities does the Volcker Rule restrict?

A. It prohibits short-term proprietary trading, except for certain permitted forms of such trading, and prohibits or restricts certain relationships with, and investments in, covered funds.

Q. Who is subject to the Regulations?

A. Companies that fall within the definition of a "banking entity" are covered by the Regulations.

The term "banking entity" has a broad reach. It applies to:

- any insured depository institution;[3]
- any company that controls an insured depository institution;[4]
- any foreign bank that maintains a branch or agency in a state, and any company that controls such a foreign bank, as well as any commercial lending company organized under state law that is a subsidiary of a foreign bank or its controlling company under section 8 of the International Banking Act of 1978 (collectively, a foreign banking organization, "FBO");[5] and

---

[3] An "insured depository institution" is any FDIC insured bank or savings institution. It does not include trust or fiduciary institutions that meet certain requirements.

[4] This includes bank holding companies ("BHCs") and savings and loan holding companies ("SLHCs"). It would also apply to any other company that controls any insured depository institution, such as an industrial bank or credit card bank that is not treated as a bank for purposes of the Bank Holding Company Act ("BHC Act").

[5] As discussed below, under certain conditions, certain activities of non-U.S. elements of an FBO may be exempt from the Trading Restrictions and Fund Restrictions.

- any affiliate or subsidiary of any of the foregoing.[6]

Entities that are designated as systemically important financial institutions (each, a "SIFI") by the Financial Stability Oversight Council ("FSOC") and that are not banking entities are not subject to the Trading Restrictions or Fund Restrictions. The Volcker Rule, however, provides that the Agencies are to adopt rules imposing additional capital charges or other restrictions on SIFIs to address the risks and conflicts of interest that are the subject of the Volcker Rule.[7]

Q. What entities are excluded from banking entity status?

A. The Regulations provide that certain entities are excluded from treatment as banking entities, thereby not subjecting them to the Trading Restrictions or the Fund Restrictions.

The Regulations exclude certain entities from being treated as a banking entity, subject to certain conditions:

- a covered fund that is not itself a banking entity by virtue of being: (i) an insured depository institution; (ii) a company that controls an insured depository institution; or (iii) an FBO;

---

6 "Affiliate" and "subsidiary" are defined in accordance with section 2 of the BHC Act. The terms are further defined under the FRB's Regulation Y implementing the BHC Act. An "affiliate" is any company that controls, is controlled by, or is under common control with, another company. A "subsidiary" is a bank or other company that is controlled by another company. Control generally is deemed to exist based on: (i) ownership, control, or power to vote 25% or more of the outstanding shares of any class of voting securities of a bank or other company, directly or indirectly or through one or more other persons; (ii) control in any manner over the election of a majority of the directors, trustees or general partners of the bank or other company; or (iii) power to exercise a controlling influence over the management or policies of the bank or other company. Thus, wherever there is an ultimate controlling parent company of an insured depository institution, then all entities that are directly or indirectly controlled by the parent company will be banking entities by virtue of these entities being under common control. In this regard, the FRB in September 2008 adopted a policy statement on equity investments in banks and BHCs that also applies to investments by BHCs in nonbanking firms. Under that policy statement, the FRB indicates, among other things, that it would not expect that a minority investor would have a controlling influence over a banking organization if the investor owns a combination of voting and nonvoting shares that when aggregated represent less than one-third of the total equity of the organization, and does not allow the investor to own, hold, or vote 15 percent or more of any class of voting securities of the organization.

As part of the originally-proposed rule, each Agency published proposed Agency-specific rules that, among other things, described the entities over which the Agency would have jurisdiction under the Volcker Rule. Under the FRB's proposed rule, a banking entity is: (1) a state member bank; (2) a BHC; (3) an SHLC; (4) an FBO; (5) any company that controls an insured depository institution; and (6) any subsidiary of the preceding entities, other than a subsidiary for which the OCC, FDIC, CFTC or SEC is the primary financial regulatory agency. As a result of this definition, in a situation where an individual controls a banking entity and also separately controls another company subject to the jurisdiction of another Agency, the FRB would not consider the other company to be an affiliate of a banking entity and thus the other company and its subsidiaries and affiliates would not be treated as banking entities. Under the OCC's proposed rule, a banking entity is: (1) a national bank; (2) a federal branch or agency of a foreign bank; (3) a federal savings association or a federal savings bank; and (4) any subsidiary of a company described in the preceding clauses (1) through (3), other than a subsidiary for which the CFTC or SEC is the primary financial regulatory agency. Under the FDIC's proposed rule, a banking entity is an insured depository institution for which the FDIC is the appropriate federal banking agency under the Federal Deposit Insurance Act. For purposes of the SEC's proposed rule, a covered banking entity is an entity for which the SEC is the primary financial regulatory agency, including broker-dealers, registered investment companies and registered investment advisers. The SEC's proposed rule provided that in the case of investment advisers, such entities are to comply with the Fund Restrictions issued by the federal banking agency that regulates the insured depository institution, company controlling an insured depository institution, or foreign banking organization with which the investment adviser is affiliated. The CFTC's proposed rule indicates that it would apply to, among other entities, registered commodity pool operators, registered commodity trading advisors, registered swap dealers, and registered major swap participants. To date, the Agencies have not published their Agency-specific final rules.

7 The preamble to the final rule noted that two of the three companies that have been designated to date as SIFIs are affiliated with insured depository institutions, and as a result are currently banking entities for purposes of the Volcker Rule. The Agencies stated that they are continuing to review whether the remaining company engages in any activity that is subject to the Volcker Rule and what, if any, requirements will apply to such an entity under the Rule. Accordingly, the Regulations do not currently include any provisions regarding a non-banking-entity SIFI.

- portfolio companies held under the merchant banking and insurance company authorities for financial holding companies under sections 4(k)(4)(H) and (I) of the BHC Act, or any portfolio concern that is controlled by a small business investment company, as those terms are defined in the Small Business Investment Act of 1958, so long as such portfolio companies or portfolio concerns do not otherwise qualify as a banking entity by virtue of being an insured depository institution, a company that controls an insured depository institution, or an FBO; and

- the FDIC acting in its corporate capacity or as a conservator or receiver under the Federal Deposit Insurance Act or Title II of the DFA.

Treatment of Registered Investment Companies

The final rule's preamble notes that a banking entity that sponsors and/or provides investment advice to a registered investment company but does not hold 25% or more of any class of voting stock of the registered investment company will not generally be deemed to control the registered investment company. Thus, under these circumstances, the registered investment company would generally not be a banking entity, unless, for example, the registered investment company itself controlled an insured depository institution. However, the definition of "control" under the Volcker Rule and how it is interpreted by the Agencies may create issues for banking entities that wish to seed and launch new investment companies, or for investment companies with large shareholders that are, themselves, banking entities.

TRADING RESTRICTIONS

Q. What Trading Restrictions do the Regulations impose?

A. Banking entities are generally prohibited from engaging in activities that qualify as proprietary trading unless an exemption applies.

"Proprietary trading" is defined as engaging as a principal for the trading account of the banking entity in any purchase[8] or sale[9] of one or more financial instruments. A "trading account" is an account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements).[10]

Q. What qualifies as a "trading account"?

A. The Regulations establish three categories of activity or status that will cause an account to be treated as a trading account: (i) it involves short-term intent, (ii) it is subject to the market risk capital requirements; or (iii) it involves purchases or sales undertaken in connection with activity that requires a banking entity to register as a dealer, a swap dealer, or a security-based swap dealer.

---

[8] The term "purchase" includes any contract to buy, purchase or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

[9] The terms "sale" and "sell" include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled delivery date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

[10] The Agencies noted that the term "trading account" does not necessarily refer to an actual account. Instead they stated that is it simply nomenclature for a set of transactions that are subject to the Trading Restrictions.

Short-Term Intent

An account will be deemed a trading account if it is used by a banking entity to acquire or take covered financial positions for the purpose of:

- short-term resale;
- benefitting from actual or expected short-term price movements;
- realizing short-term arbitrage profits; or
- hedging one or more positions resulting from the purchases or sales of financial instruments described above (together, the foregoing are referred to as "short-term intent").

The purchase or sale of a financial instrument for a banking entity shall be presumed to be for the trading account of a banking entity if it holds the financial instrument for fewer than 60 days or substantially transfers the risk of the financial instrument within 60 days of the purchase or sale, unless the banking entity can demonstrate, based on all relevant facts and circumstances, that it did not purchase or sell the financial instruments for any of the short-term purposes described above.

Short-Term Intent and Community and Regional Banks

The short-term intent definition is expected to establish the bounds of proprietary trading for small and regional banking entities that are not subject to the market risk capital rules and are not registered dealers or swap entities. The Agencies indicated that the 60 day provision does not provide a safe harbor or a reverse presumption that positions held for 60 days or more are outside of the trading account, stating that some proprietary trading could occur outside of the 60-day period. At the same time, the presumption allows for the Agencies and banking entities to evaluate all the facts and circumstances related to the trading activity in determining whether the activity will be considered to be prohibited proprietary trading. In that regard, the Agencies noted that trading in a financial instrument intended for long-term investment that is disposed of within 60 days because of unexpected developments (such as an unexpected increase in a financial instrument's volatility or a need to liquidate the instrument to meet unexpected liquidity demands) may not be prohibited trading activity.

Market Risk Capital Rule Covered Positions

An account is also a trading account if it is used to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital covered positions) if the banking entity, or any affiliate of the banking entity (i) is an insured depository institution, BHC or SLHC, and (ii) calculates risk-based capital ratios under the federal banking agencies' market risk capital rule.

The market risk capital rule applies to trading positions held by banking entities subject to that rule, which positions are for the purpose of short-term resale or with the intent of benefitting from actual or expected short-term price movements or to lock-in arbitrage profits. The Agencies observed that these concepts are similar to the definition of proprietary trading in the Volcker Rule and the Regulations' definition of short-term intent, and, thus, reinforce the consistency between the governance of market risk capital trading positions and trading accounts under the Regulations.

Dealer Activity Trading Accounts

An account will also be considered to be a trading account if it is used to purchase or sell one or more financial instruments for any purpose, if the banking entity:

- is licensed or registered, or required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the position is purchased

or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

- is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

The Agencies' Reaction to the Comments
About Dealer Activity

The Agencies acknowledged commenters' concern about the scope of activity that could be covered by the dealer activity trading account provision. They indicated that this concern was mitigated to some extent by exemptions from the proprietary trading prohibitions that are available for dealer activities such as market-making, hedging, and underwriting.

They stressed that the dealer activity trading account provision applies only to the dealer trading activities of a banking entity, which are not necessarily all of the activities of the entity. While an insured depository institution may be registered as a swap dealer, only swap dealer activities that require the institution to be registered as a swap dealer will be included in the dealer trading account. Thus, if such an institution purchases or sells a financial instrument in connection with activities that do not trigger registration as a swap dealer, the financial instrument is included in the institution's trading account only if the instrument otherwise triggers the short-term intent provision or is subject to the market risk capital rule.

Commenters had objected on various grounds to the application of the dealer trading account provisions to banking entities acting as dealers outside the United States. The Agencies provided no relief in the final rule in that regard, citing concerns that doing so would lead to regulatory arbitrage and noting the availability of the non-U.S. activities exemption for certain entities which have an ultimate non-U.S. parent company.

Q. What is a "financial instrument"?

A. A "financial instrument" means:

- **a security, including an option on a security;**
- **a derivative**[11]**, including an option on a derivative; or**
- **a contract of sale of a commodity for future delivery**[12]**, or an option on a contract of sale of a commodity for future delivery.**

A financial instrument does not include: (i) a loan;[13] (ii) a commodity[14] that is not (A) an excluded commodity[15] (other than foreign exchange or currency), (B) a derivative, (C) a contract of sale of a commodity for future

[11] A "derivative" is: (i) any swap or security-based swap as defined in specified provisions of the CEA or the Securities Exchange Act of 1934 ("Exchange Act"); (ii) any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled; (iii) any foreign exchange forward or foreign exchange swap as defined in specified provisions of the CEA; (iv) any agreement, contract, or transaction in foreign currency as specified under a provision of the CEA; (v) any agreement, contract, or transaction in a commodity other than foreign currency in a specified provision of the CEA; and (vi) any transaction authorized under section 19 of the CEA.

A derivative does not include: (i) any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation or other guidance as not within the definition of swap or security-based swap as defined in specified provisions of the CEA or the Exchange Act; or (ii) any identified banking product in accordance with specified statutory provisions.

[12] "A contract of sale of a commodity for future delivery" has the meaning set forth in a specified provision of the CEA.

delivery; or (D) an option on a contract of sale of a commodity for future delivery; or (iii) foreign exchange or currency.

Q. What accounts are excluded from proprietary trading?

A. The proposed rule would have established four exclusions from the term "proprietary trading." The Regulations expanded these exclusions to nine types of activities.

1. Repos and Reverse Repurchase Agreements. Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset at stated prices and on stated dates, or on demand with the same counterparty.

2. Securities Lending. Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties.[16]

3. Liquidity Transactions. Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan that must meet six requirements. These include that any securities purchased or sold must be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements, and that limit any securities purchased or sold for liquidity management purposes to an amount that is consistent with the banking entity's near term funding needs, including deviations from normal operations, as estimated and documented in the banking entity's plan.

4. Derivatives Clearing. Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or clearing agency, in connection with clearing financial instruments.

5. Excluded Clearing Activities. Any excluded clearing activities[17] by a banking entity that is a member of a clearing agency, a derivatives clearing organization, or a designated financial market utility.

6. Clearing Settlement or Proceeding-Related Activities. Any purchase or sale of one or more financial instruments by a banking entity, so long as: (i) the purchase or sale satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or (ii) the purchase or sale satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization or arbitration proceeding.

---

[13] A "loan" is any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

[14] A "commodity" has the meaning set forth in a specified provision of the Commodity Exchange Act ("CEA").

[15] An "excluded commodity" has the meaning set forth in a specified provision of the CEA.

[16] The Agencies were influenced in regard to the exclusion of repurchase and reverse repurchase agreements and securities lending agreements by Congress' recognition in the DFA that these agreements are loans or extensions of credit, by including them in legal lending limits, thereby supporting the view that such transactions do not, in normal practice, represent proprietary trading. They noted, however, that the collateral or position that is being financed by the repurchase or reverse repurchase agreement is not excluded and may involve proprietary trading. They further explained that if a banking entity uses a repurchase agreement or reverse repurchase agreement to finance a purchase of a financial instrument, other transactions involving that financial instrument may not qualify for the exclusion.

[17] The term "excluded clearing activities" has a five-prong definition set forth in the Regulations.

7. Agent, Broker, or Custodian Transactions. Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian.

8. Employee Plan Transactions. Any purchase or sale of one or more financial instruments by a banking entity through certain compensation or retirement plans of the banking entity, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity.

9. Debt Previously Contracted Transactions. Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than the period permitted by the applicable Agency.

Q. What proprietary trading activities are permitted by the Regulations?

A. The Regulations allow a banking entity to engage in a range of activities that qualify as proprietary trading, provided that the banking entity meets the requirements for particular exceptions, as discussed below.

Permitted Underwriting Activities

The general prohibition on proprietary trading does not apply to a banking entity's underwriting activities that meet certain requirements set forth in the Regulations. The requirements include that:

- The banking entity is acting as an underwriter[18] for a distribution[19] of securities and the trading desk's underwriting position is related to such distribution;

- The amount and type of securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties,[20] and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security; and

- The banking entity has established, implements, and enforces an internal compliance program that meets the requirements set forth in the Regulations. The compliance program, among other things, must set forth limits on each trading desk's exposures and the period of time for which a security may be held, and provide that the compensation arrangements of persons performing permissible underwriting activities are designed not to reward or incentivize prohibited proprietary trading.

Permitted Market Making-Related Activities

One of the most controversial aspects of the Trading Restrictions was the scope of permissible market making-related activities. Many commenters expressed concern that a narrow interpretation of permissible market making-related activities would effectively result in a dramatic reduction of market-making activity by

[18] An "underwriter" is a person who has (i) agreed with an issuer or selling security holder to: (A) purchase securities from the issuer or selling security holder for distribution, (B) engage in a distribution of securities for or on behalf of the issuer or selling security holder or (C) manage a distribution of securities for or on behalf of the issuer or selling security holder; or (ii) agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

[19] A "distribution" is (i) an offering of securities, whether or not subject to registration under the Securities Act of 1933 ("Securities Act"), that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or (ii) an offering made pursuant to an effective registration statement under the Securities Act.

[20] The term "client, customer, and counterparty" refers to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

banking entities that would, among other things, result in increased costs of raising capital or higher financing costs.

In adopting the Regulations, the Agencies acknowledged that a reduction in market making by banking entities might lead to some general reductions in liquidity of certain asset classes, particularly in low volume markets. They contended, however, that over time non-banking entities may provide much of the liquidity that is lost by restrictions on banking entities' market-making activities. They also stressed that they were trying to ameliorate the Regulations' potential adverse effects by, among other things, establishing criteria that can be applied based on the liquidity, maturity, and depth of the market for a particular type of financial instrument, so that the Agencies can appropriately recognize the challenges posed for predicting near term customer demand in less liquid markets.

The Agencies gave particular attention to trading in ETF shares by institutions known as "authorized participants" ("APs"),[21] as well as other market participants. The Agencies stated explicitly that various trading activities in ETF shares on the part of banking entities, including those banking entities that serve as APs, can qualify under the final rule's market-making exemption if such activities meet the exemption's criteria.[22] The eligible trading activities specifically identified by the Agencies include: (a) acquiring or accumulating an inventory of financial instruments for the purpose of seeding a new ETF or otherwise conveying such instruments to the ETF in return for a large aggregation of ETF shares known as a "creation unit;" (b) borrowing underlying instruments, conveying them to an ETF in return for a creation unit of ETF shares and lending those ETF shares to a customer (*i.e.*, "create-to-lend" transactions), and (c) generally engaging in buying and selling shares of an ETF and its underlying instruments in the market to capitalize on arbitrage opportunities between the two and thus maintain price continuity between the ETF and its underlying instruments. The Agencies noted the importance of that last form of trading to the liquidity of the ETF market, stating that such trading can be considered market-making activity "[b]ecause customers take positions in ETFs with an expectation that the price relationship will be maintained."

The final rule, like the proposed rule, focuses on ensuring that the market making-related activities of a banking entity are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.

The general prohibition on proprietary trading does not apply to a banking entity's market making-related activities that meet certain requirements set forth in the Regulations. The requirements include that:

- The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into, long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout the market cycles, on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

- The amount, types and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties based on: (i) the liquidity, maturity, and depth of the market for the relevant types of financial instruments; and (ii) demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of, or associated with, financial instruments in which the trading desk makes a market; and

[21] APs are financial institutions that enter into relationships with ETFs to serve in that capacity. Only APs are permitted to purchase and redeem shares directly from the ETF, and they can do so only in large aggregations commonly referred to as "creation units."

[22] When an AP accumulates an inventory of instruments for the purpose of conveying them to an ETF to create ETF shares, the market participants who transact with the AP in the AP's accumulation activities would be considered "clients, customers or counterparties" of the AP for purposes of the market-making exemption criteria. Similarly, the Agencies confirmed that when an AP conveys instruments to the ETF and creates ETF shares, the ETF itself would be considered the AP's "clients, customers or counterparties."

- The banking entity has established, maintains, and enforces an internal compliance program that is reasonably designed to ensure compliance with the requirements for permissible market making-related activities, consistent with certain principles and requirements set forth in the Regulations, including that the compensation arrangements of persons performing market making-related activities are designed not to reward or incentivize prohibited proprietary trading.

Permitted Risk-Mitigating Hedging Activities

Another controversial aspect of the Trading Restrictions was the scope of risk-mitigating hedging. Commenters on the proposed rule expressed a wide range of concerns regarding the manner in which the proposed permissible hedging activities provision would operate. Among other things, they asserted that banking entities would not be able to use the full range of transactions that are available for hedging, that they would not be permitted to engage in portfolio hedging, and that restrictions on a banking entity's ability to hedge may have a chilling effect on its willingness to engage in other permissible activities including market making.

The Regulations do not provide banking entities with the full degree of flexibility that some commenters sought in conducting hedging activities. In that regard, the Agencies noted that the Volcker Rule itself does not refer to portfolio hedging. Permissible hedging under the Regulations must mitigate one or more specific risks arising from an identified position or aggregation of positions. Thus, permissible hedging activity cannot be designed to: reduce general risks associated with a banking entity's assets and/or liabilities, general market movements or broad economic conditions; profit in the case of a general economic downturn; counterbalance revenue declines generally; or otherwise arbitrage market imbalances unrelated to risks resulting from positions held by the banking entity.

The general prohibition on proprietary trading does not apply to a banking entity's risk-mitigating hedging activities conducted in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity, and that is designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings. A banking entity conducting permissible hedging activities must meet certain requirements set forth in the Regulations, including the following:

- The banking entity has established, maintains, and enforces an internal compliance program that is reasonably designed to ensure compliance with the requirements for permissible risk-mitigating hedging activities, consistent with certain principles and requirements set forth in the Regulations. Such a program must include the following elements:

    - reasonably designed written policies and procedures regarding the positions, strategies and techniques that may be used for hedging;

    - internal controls and ongoing monitoring, management, and authorization procedures; and

    - analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks being hedged.

- The hedging activity itself must meet certain requirements, including that:

    - it is conducted in accordance with the banking entity's written policies and procedures and internal controls;

    - at inception, including any adjustments, it is designed to reduce or otherwise significantly mitigate and demonstrably reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, credit risk, currency risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of a banking entity based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

- ❑ it does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in a manner permissible under the Regulations; and

- ❑ it must be subject to continuing review by the banking entity to ensure that the compensation arrangements of persons performing the hedging activities are not designed to reward or incentivize prohibited proprietary trading.

Permitted Trading in U.S. Government and Government-Related Obligations

The proprietary trading prohibitions do not apply to a purchase or sale of: (i) an obligation of, or issued or guaranteed by, the United States; (ii) an obligation, participation or other instrument of, or issued or guaranteed by, an agency of the United States, Ginnie Mae, Fannie Mae, Freddie Mac, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or certain Farm Credit System institutions; (iii) an obligation of a state or a subdivision thereof, including any municipal security; or (iv) certain FDIC-related obligations. The Agencies responded to requests by commenters by expanding the range of permissible state and local securities to include obligations of agencies of states or political subdivisions, as well as government entities acting as instrumentalities on behalf of states or political subdivisions thereof.

Permitted Trading in Foreign Government Obligations

The proposed rule did not provide any exemption for proprietary trading involving foreign government obligations. Many commenters, including foreign governments, requested that an exemption be granted to foreign government obligations. The Agencies responded to the commenters' requests to a limited extent.

- Foreign Banking Entities with an Ultimate Foreign Parent. The proprietary trading prohibition does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision thereof, if:

  - ❑ the banking entity is organized under, or is directly or indirectly controlled by, a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

  - ❑ the financial instrument is an obligation of, or issued or guaranteed by, a foreign sovereign under the laws of which the foreign banking organization referred to above is organized, or any agency or political subdivision thereof; and

  - ❑ the purchase or sale as principal is not made by an insured depository institution.

- Foreign Affiliates of a U.S. Banking Entity. The proprietary trading prohibition does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States, so long as:

  - ❑ the foreign entity qualifies as a foreign bank under the FRB's Regulation K, or is regulated by the foreign sovereign as a securities dealer;

  - ❑ the financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision thereof; and

  - ❑ the financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in, or organized under the laws of, the United States.

Permitted Trading by a Regulated Insurance Company

The proprietary trading prohibitions do not apply to the purchase or sale of a financial instrument by a banking entity that is an insurance company or an affiliate of such insurance company if:

- the insurance company or its affiliate purchases or sells the financial instrument solely for: (i) the general account[23] of the insurance company; or (ii) a separate account[24] established by the insurance company;
- the purchase or sale must be conducted in compliance with, and subject to, insurance company investment laws, regulations and written guidance of the applicable state or other jurisdiction of domicile; and
- the appropriate federal banking agencies, after consultation with the FSOC and the relevant insurance commissioners of the states and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.[25]

Permitted Trading on Behalf of Customers

The general prohibition on proprietary trading does not apply to certain purchases and sales of financial instruments on behalf of a banking entity's customers. This exemption is available in the following situations:

- The banking entity is acting as trustee or in a similar fiduciary capacity, so long as the transaction is conducted for the account of, or on behalf of, a customer, and the banking entity does not have or retain beneficial ownership of the financial instruments. The Agencies removed the proposed rule's express reference to a banking entity acting as an investment adviser, stating that they did not believe such a reference was necessary since investment advisers generally act in a fiduciary capacity on behalf of clients in a manner that is separately covered by other exclusions and exemptions in the Regulations.[26]
- The banking entity is acting as a riskless principal in a transaction in which the banking entity, after receiving an order to purchase or sell a financial instrument from a customer, purchases or sells the financial instrument for its own account to offset a contemporaneous sale to or purchase from the customer.

Permitted Non-U.S. Trading by Foreign Banking Entities with a Foreign Entity Ultimate Parent

An exemption is provided for non-U.S. proprietary trading by a foreign banking entity with a foreign entity ultimate parent, which meets the following requirements:

---

[23] A "general account" is defined as all of the assets of an insurance company except those allocated to one or more separate accounts.

[24] A "separate account" is defined as an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from the assets allocated to such account, are in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

[25] The Agencies noted that the federal banking agencies have not determined that any particular laws, regulations, or written guidance are insufficient, but expect to monitor these on an ongoing basis in conjunction with the FSOC.

[26] The proposed rule's express reference to commodity trading advisors was removed because the legal relationship between a commodity trading advisor and its client depends on the facts and circumstances of each relationship. As a result, they determined to use a reference to a fiduciary relationship and omit any specific discussion of commodity trading advisors.

- With respect to a banking entity that is an FBO, the banking entity meets the requirements to be a qualified foreign banking organization, or with respect to a foreign banking entity that is not an FBO – because, for example, it controls a savings and loan holding company or an FDIC-insured industrial loan company – the banking entity is not organized under the laws of the United States and the banking entity, on a fully consolidated basis, meets certain requirements regarding its activities.

As a result of the terms of the Volcker Rule, no entity that has an ultimate U.S. parent entity, including a foreign banking entity that is a subsidiary organized under foreign law or a foreign branch office of a U.S. banking organization, may utilize this exemption.

- The purchase or sale must meet certain requirements, including the following:
  - the banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliates who arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under U.S. law;
  - the banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under U.S. law;
  - the purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under U.S. law;
  - no financing for the banking entity's purchases or sales is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under U.S. law; and
  - the purchase or sale is not conducted with or through any U.S. entity, other than:
    - a purchase or sale with the foreign operations of a U.S. entity, if no personnel of such U.S. entity that are located in United States are involved in the arrangement, negotiation, or execution of such purchase or sale;
    - a purchase or sale with an unaffiliated market intermediary acting as a principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or
    - a purchase or sale through an unaffiliated market intermediary acting as an agent, provided that the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

For these purposes, a "U.S. entity" is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under U.S. law. A U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign banking entity that operates or controls that branch, agency or subsidiary is not considered to be located in the United States.

Q. What other restrictions apply to permitted proprietary trading and potentially override the authority to engage in permitted proprietary trading activities?

A. No transaction, class of transactions or activity may be deemed permissible under one of the exemptions for permitted proprietary trading, if the transaction, class of transactions, or activity would:

- **involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;**

- **result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or high-risk trading strategy; or**

- **pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.**

Material Conflicts of Interest

A material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of the client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of two actions provided in the Regulations. Those actions are (i) a timely and effective disclosure of the conflict of interest, or (ii) an information barrier. As discussed below, the efficacy of either of these actions is to be evaluated on a case-by-case basis.

Agency Statements Regarding Timely and Effective Disclosure of Conflicts

A banking entity may address a material conflict of interest by making timely and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest, and such disclosure must be made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest.[27]

Disclosure provided far in advance of a particular transaction, such that the client, customer, or counterparty is unlikely to take that disclosure into account when evaluating the transaction, would not be sufficient. Similarly, disclosure provided without a sufficient period of time for the client, customer, or counterparty to evaluate and act on the information it receives, or disclosure provided after the fact, would not be sufficient disclosure under the Regulations.

The effectiveness of disclosures will depend on the customer relationship, the type of transaction, and the matter that creates the potential conflict. While written disclosures may be appropriate, they are not required, nor is documentation showing that the disclosure was received. [28]

[27] Certain inherent conflicts of interest, such as the mere fact that the buyer and seller are on opposite sides of the transaction and have differing economic interests, would not be deemed to be a material conflict of interest with respect to permitted proprietary trading activities.

[28] The Agencies declined to follow commenters' suggestions regarding providing additional certainty with respect to the method, scope, or specific content of disclosures. They took the position that providing specific guidance on disclosure may provide an incentive for banking entities to consider the form of disclosure provided, rather than whether the disclosure can address the substance of the specific conflict. They asserted that banking entities are in the best position to identify and evaluate the conflicts present in their business as well as the most effective method of disclosing conflicts, and should tailor their compliance programs to identify, monitor, and evaluate potential conflicts of interest based on their business structure and specific activities and customer relationships.

Agency Statements Regarding Information Barriers

A banking entity may also address a material conflict of interest by establishing, maintaining and enforcing information barriers that are contained in written policies and procedures – such as physical separation of personnel, or functions, or limitations on types of activity – that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers, if in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or reasonably should know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

The Agencies cautioned that conflict of interest concerns may be elevated when, among other things, a transaction is complex, highly structured, opaque, or involves a significant asymmetry of information or transactional data among participants. Nevertheless, they stressed that the question of whether a material conflict of interest exists will depend on an evaluation of the specific facts and circumstances. Thus, the Agencies stated that certain simple transactions may implicate conflicts of interest that cannot be mitigated by disclosure or restricted by information barriers. On the other hand, they stated that highly structured and complex transactions may involve conflicts of interest that can be mitigated by disclosure or restricted by information barriers.

High-Risk Assets and High-Risk Trading Strategies

The Regulations provide the following definitions for the terms "high-risk asset" and "high-risk trading strategy":

- A high-risk asset means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

- A high-risk trading strategy means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

A banking entity that engages in permissible proprietary trading activities must have a reasonably designed compliance program to monitor and understand whether it is exposed to high-risk assets or high-risk trading strategies. While recognizing that commenters had requested a clearer definition of high-risk assets and high-risk trading strategy, the Agencies determined to include a broad definition of these terms that accounts for different facts and circumstances. According to the Agencies, a trading strategy or asset may be high-risk for one banking entity but not for another, or may be high-risk to a banking entity under some market conditions but not others.

Future Agency Action

The Agencies noted that they intend to develop additional guidance regarding best practices for addressing material conflicts of interest, high-risk assets and trading strategies and practices that pose significant risks to safety and soundness and to the U.S. financial system as the Agencies and banking entities gain experience with implementation of the requirements and limitations of the Volcker Rule and the Regulations.

FUND RESTRICTIONS

Scope

Q. What prohibitions and restrictions will apply to covered fund activities?

A. A banking entity is prohibited from acquiring or retaining an ownership interest in, or sponsoring, a covered fund, as a principal, directly or indirectly, subject to certain exceptions. A banking entity that serves as an investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, and any affiliates of the banking entity, are prohibited from entering into certain "covered transactions" with covered funds, as that term is defined in section 23A of the Federal Reserve Act ("FRA"). In addition, the "arm's length" restrictions contained in section 23B of the FRA will apply to other types of transactions that a banking entity with certain relationships with a covered fund may have with the covered fund. The section 23A prohibitions and section 23B transaction requirements are referred to as "Fund Transaction Provisions."

Q. What activities qualify as non-principal activities that are excluded from the Fund Restrictions on sponsorship and investment?

A. Four types of activities are deemed to be non-principal activities and are not subject to the prohibitions on sponsorship and investment.

The prohibition on acquiring or attaining an ownership interest does not apply to a banking entity acting:

- solely as agent, broker, or custodian, so long as the activity is conducted for the account of, or on behalf of, a customer, and the banking entity and its affiliates do not have or retain beneficial ownership of the ownership interest;
- through a U.S. or foreign deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof), if the ownership interest is held or controlled directly or indirectly by a banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);
- in the ordinary course of collecting a debt previously contracted in good faith (under certain conditions); or
- on behalf of a customer as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as the activity is conducted for the account of the customer and the banking entity and its affiliates do not have or retain beneficial ownership of the ownership interest.

Q. What is a "covered fund"?

A. Three categories of entities are subject to the term "covered fund." They are: (i) entities relying on a section 3(c)(1) or 3(c)(7) exclusion from investment company status; (ii) certain commodity pools; and (iii) certain foreign funds. An entity's status as a covered fund triggers the general prohibitions on banking entity sponsorship of, and the acquisition and retention of ownership interests in, a covered fund. It also may trigger the Fund Transaction Provisions.

Entities Relying on a Section 3(c)(1) or 3(c)(7) Exclusion from Investment Company Status

A covered fund includes an issuer that would be an investment company, as defined under the Investment Company Act of 1940 ("ICA"), but for the exclusions provided by section 3(c)(1) or 3(c)(7) of the ICA. It is important to note that an issuer that could rely on any other exclusion or exception from investment company status, either under the ICA or the rules thereunder, would not be a covered fund even though it could also rely on the section 3(c)(1) or 3(c)(7) exclusions.[29]

Certain Commodity Pools

Under the proposed rule, any commodity pool, as defined in section 1a(10) of the CEA, would have been treated as a covered fund. Pursuant to the DFA and the CFTC and SEC implementing regulations, a commodity pool now encompasses many vehicles that invest in derivatives, including some registered investment companies. The final rule substantially scales back this trigger for covered fund status. Under the Regulations, subject to certain exceptions for foreign public funds, a commodity pool will be a covered fund only if:

- the commodity pool operator ("CPO") has claimed a CPO operational exemption under CFTC Regulation 4.7; or
- the CPO is registered with the CFTC as a CPO in connection with the operation of the pool; substantially all participation units of the pool are owned by qualified eligible persons ("QEPs") under CFTC Regulation 4.7; and participation units of the pool have not been publicly offered to persons who are not QEPs.

The more tailored approach taken in regard to commodity pools in the final rule is designed to include as covered funds those pools that are similar to funds that rely on the exclusions in section 3(c)(1) or 3(c)(7) of the ICA, while not including as covered funds types of entities (such as commercial end-users and registered investment companies) whose activities do not create the concerns that the Volcker Rule was designed to address.

Certain Foreign Funds

Under the proposed rule, a covered fund would also have included an issuer organized or offering interests outside of the United States, which would be a covered fund if it were organized in the United States. Commenters expressed a wide range of objections to this approach.

The Agencies responded to these comments by narrowing the circumstances under which a foreign fund (not otherwise offering or selling its interests in the United States or to U.S. persons) would be treated as covered fund, and by providing an exclusion from covered fund status for qualifying foreign public funds.

The term "covered fund" includes, for any banking entity that is, or that is controlled directly or indirectly by, a banking entity that is, located in the United States or organized under U.S. law ("U.S.-based banking entity"), a foreign fund that:

- is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

---

[29] The Agencies recognized that this definition would treat many entities as covered funds that would not generally be viewed as presenting the types of risks that the Volcker Rule intended to address with its focus on private equity funds and hedge funds. In the proposed rule, they sought to address this concern by permitting certain relationships with entities that were not viewed as posing private equity fund or hedge fund type risks but nevertheless would fall within the definition of a covered fund.

In the final rule, the Agencies decided to address this issue by expressly excluding a broad range of entities from the term covered fund. This avoids issues related to sponsorship of, and holding ownership interests in, these excluded entities, as well as issues that would otherwise arise under the Fund Transaction Provisions.

- is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities; and

- has as its sponsor that U.S.-based banking entity (or an affiliate thereof) or has issued an ownership interest that is owned directly or indirectly by that U.S.-based banking entity (or an affiliate thereof).

Under this definition, a foreign fund becomes a covered fund only with respect to a U.S.-based banking entity or a foreign affiliate of a U.S.-based banking entity that acts either as a sponsor to the foreign fund or has an ownership interest in the foreign fund. For these purposes, a U.S. branch, agency, or subsidiary of a foreign banking organization is deemed to be located in the United States. A foreign bank that operates in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary is not considered to be located in the United States. Under this approach, the same foreign fund would be a covered fund with respect to sponsorship or investment by a U.S.-based banking entity, but would not be a covered fund with respect to a foreign bank that invests in the fund solely outside of the United States.

As with U.S. funds and foreign funds offered or sold in the United States or to U.S. persons, a foreign fund would not be a covered fund if, were the issuer subject to U.S. securities laws, the fund could rely on an exclusion or exception from the definition of investment company under the ICA other than the exclusions contained in section 3(c)(1) or 3(c)(7) of the ICA.

Q. Who is considered to be a sponsor of a covered fund?

A. A sponsor is an entity that: (i) serves as a general partner, member, trustee, or CPO of a covered fund; (ii) in any manner selects or controls (or has employees, officers, directors, or agents who constitute) a majority of the directors, trustees or management of a covered fund; or (iii) shares a name or similar name with a covered fund for corporate, marketing, promotional or other purposes.

In a change from the proposed rule, the final rule clarifies the definition of "trustee" for purposes of the term "sponsor," to exclude a trustee who does not exercise investment discretion with respect to a covered fund, including a trustee who is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to a specified provision of the Employee Retirement Income Security Act or substantially equivalent foreign standards ("excluded trustee"). Any entity that directs an excluded trustee, or that possesses the authority and discretion to manage and control the investment decisions of a covered fund for which such excluded trustee serves as trustee, will be considered to be a trustee of the covered fund.

Q. What constitutes an ownership interest in a covered fund?

A. The Regulations set forth an expanded explanation of the types of interests and characteristics that will be deemed to constitute an ownership interest.

An important element of the Fund Restrictions is the definition of an "ownership interest." An ownership interest is an equity, partnership, or similar interest. In a significant change from the proposed rule, the Agencies in the final rule added language setting forth characteristics that would cause an interest to be deemed to constitute a "similar interest." A "similar interest" means an interest that:

- has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding rights of creditors to exercise remedies upon the occurrence of an event or a default or acceleration event);

- has the right to receive a share of the income, gains or profits of the covered fund;

- has the right to receive the underlying assets of the covered fund, after all other interests have been redeemed and/or paid in full – *i.e.,* the "residual" (excluding the rights of creditors to exercise remedies upon the occurrence of an event of default or acceleration event);

- has the right to receive all or a portion of excess spread;

- provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund;

- receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the covered fund's assets (except for interests that are entitled to receive dividend amounts calculated at a fixed or at a floating rate based on an index or interbank rate); or

- provides any synthetic right to have, receive or be allocated any of the foregoing rights.

The Agencies acknowledged that this broad definition of ownership interest may result in certain interests being ownership interests under the Regulations, but not in other contexts. They indicated, however, that they believe the broad definition is necessary to avoid potential evasion of the Volcker Rule through investments in nominal debt instruments that exhibit characteristics of ownership interests.

Banking entities will need to review their holdings in covered funds to evaluate whether any of them may qualify as ownership interests for purposes of the Fund Restrictions. In that regard, we note the expanded definition of similar interest has raised significant concerns with respect to the treatment under the Regulations of the "controlling class" of debt issued by collateralized loan obligation ("CLO") vehicles, which typically give the holders of such debt the right to remove the CLO manager "for cause" and to participate in the selection of the replacement manager following such a removal or the CLO manager's resignation under circumstances in which there is no event of default or acceleration of the debt. See our *Dechert OnPoint*, *CLOs Under the Volcker Rule: New Exemptions, New Issues, New Obligations*.[30]

In a similar context, on December 24, 2013, the American Bankers Association and several banks, among other actions, filed an action in the U.S. Court of Appeals for the District of Columbia Circuit seeking a stay of the portion of the Regulations which would cause debt instruments that are widely held by banking entities – known as TruPS-backed collateralized debt obligations ("CDOs") – to be deemed to be ownership interests in covered funds under the Regulations. On December 27, 2013, the Agencies issued a statement indicating that they were considering whether it would be appropriate to not treat pooling vehicles that invest in TruPS as covered funds. On January 14, 2014, the Agencies issued an interim final rule providing that the prohibition on a banking entity holding ownership interest in, or sponsoring, a covered fund does not apply in the case of certain issuers of CDOs backed by trust preferred securities. This provision applies if: (i) the issuer was established, and the interest was issued, before May 19, 2010; (ii) the banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral;[31] and (iii) the banking entity acquired such interest on or before December 10, 2013.

The proposed rule excluded carried interest from the definition of ownership interest. The final rule retains this exclusion with certain modifications, although it uses the term "restricted profit interest" rather than "carried interest." The final rule provides that an excluded restricted profit interest means an interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider, provided that, among other things:

- the sole purpose and effect of the interest is to allow the entity (or employee or former employee) to share in the profits of the covered fund as performance compensation for

---

30 See also Letter from The Loan Syndications Trading Association, the Securities Industry and Financial Markets Association, the Structured Finance Industry Group, the American Bankers Association, and the Financial Services Roundtable to Chairman Bernanke, Comptroller Curry, Chairman Gensler, Chairman Gruenberg and Chair White (Dec. 24, 2013) (requesting that the Agencies confirm that the term "ownership interest" does not include debt securities of CLO issuers that are covered funds, where these securities give holders a contingent right to remove a manager "for cause" or to nominate or vote on a nominated replacement upon a manager's resignation or removal, but contain none of the other indicia of ownership interest listed in the definition) and supplemental letters dated December 31, 2013 and January 10, 2014.

31 "Qualifying TruPS Collateral" means any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15 billion or was issued prior to May 19, 2010 by a mutual holding company.

services provided to the covered fund, and further provided that the banking entity (or employee or former employee) may be obligated under the terms of such interest to return profits previously received;

- all such profit, once allocated, is distributed to the entity (or employee or former employee) promptly after being earned or, if not so distributed, is retained solely to establish reserves to satisfy contractual obligations with respect to subsequent losses, and the undistributed profit of the entity does not share in subsequent gains or losses (*i.e.*, a "clawback" feature);

- any amounts invested in the covered fund, including amounts paid to acquire the restricted profit interest, are within the limitations of Section _.12 of the Regulations; and

- the interest is not transferable by the entity (or employee or former employee) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy of the employee or former employee, or in connection with the sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee) to an unaffiliated party that provides services to the covered fund.

Q. What types of entities are excluded from treatment as covered funds?

A. One of the major changes to the Fund Restrictions portion of the proposed rule was the Agencies' decision to provide exclusions from covered fund status to a significant number of types of entities that might otherwise be treated as covered funds. The Regulations provide that even if an entity falls into one of the three categories of entities that are deemed to be covered funds, it will not be a covered fund if it qualifies for one of the 13 exclusions set forth in the Regulations.

Foreign Public Funds

Commenters' concerns about the treatment of foreign public funds, such as UCITS, are intended to be addressed by excluding certain foreign public funds from the definition of covered funds under certain conditions. A general exclusion from the definition of covered fund is provided for any issuer that:

- is organized or established outside of the United States;

- is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction;[32] and

- sells ownership interests predominantly through one or more public offerings outside of the United States.[33]

The Regulations impose additional requirements in the case of an issuer sponsored by a banking entity that is, or is controlled directly or indirectly by, a banking entity located in the United States or organized under U.S. law. In those circumstances, a sponsoring banking entity may not rely on the exclusion for a foreign public fund, unless ownership interests in such issuer are sold predominantly to persons other than: (i) the sponsoring banking entity; (ii) the issuer; (iii) affiliates of such sponsoring banking entity or such issuer; or (iv) directors and employees of such entities.[34]

---

[32] The Agencies noted that, for purposes of this exclusion, "retail investors" will be construed to refer to members of the general public who do not possess the level of sophistication and investment experience typically found among institutional investors or high net worth investors.

[33] The Agencies indicated that the requirement that ownership interests be sold predominantly through one or more public offerings outside of the United States is expected to reinforce the retail focus of the exclusion. They further noted that they generally expect that an offering will be made predominantly outside the United States if 85% of more of the fund's interests are sold to investors that are not residents of the United States.

[34] In regard to a foreign public fund sponsored by a U.S. banking entity or a foreign banking entity controlled by a U.S. banking entity, the Agencies likewise noted that they would generally expect that a fund would satisfy the special

Wholly-Owned Subsidiaries

In another important change from the proposed rule, a broad exclusion from covered fund status was included for wholly-owned subsidiaries in the final rule. Under the proposed rule, a banking entity would have been permitted to sponsor, and invest in, wholly-owned subsidiaries that are covered funds, but only to the extent such entities were engaged in certain *bona fide* liquidity management activities.

In response to requests from commenters, the Agencies expanded this exemption to provide that wholly-owned subsidiaries will not be treated as covered funds regardless of the activity in which they are engaged.[35] A subsidiary will be treated as wholly-owned under circumstances where up to 5% of the entity's ownership interests may be owned by directors, employees, and certain former directors and employees of the banking entity (or affiliate thereof).[36]

Joint Ventures

The proposed rule would have permitted a banking entity to invest in or manage a joint venture that was a covered fund, which was a joint venture between the banking entity and any other person, provided that the joint venture was an operating company and did not engage in any activity or any investment not permitted under the proposed rule. Commenters sought a broader exemption and urged that it not be limited to operating companies, noting that banking entities often enter into joint ventures with non-operating companies.

The Regulations include a substantially broadened joint venture provision. A joint venture will not be treated as a covered fund if the joint venture:

- is comprised of no more than 10 unaffiliated co-venturers;
- is in the business of engaging in activities that are permissible for the banking entity or affiliate, other than investing in securities for resale or other disposition; and
- is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.[37]

Acquisition Vehicles

An issuer that is formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction, and that exists only for such period as necessary to effectuate the transaction, is excluded from treatment as

---

ownership requirement applicable in such circumstances if 85% or more of the fund's interests are sold to persons other than the sponsoring banking entity and certain persons connected to that entity.

[35] The Agencies noted that, although a qualifying wholly-owned subsidiary would be excluded from being treated as a covered fund, that subsidiary would itself be a banking entity and thus would be subject in its own activities to the prohibitions and other provisions of the Volcker Rule and the Regulations.

[36] Within the 5% limit, up to 0.5% of the entity's ownership interests may be held by a third party, provided the interests are held by a third party for the purpose of establishing corporate separateness or addressing bankruptcy or similar concerns.

[37] The limit of 10 unaffiliated joint venturers was provided to allow flexibility in structuring larger business entities – without having such a large number of partners as to suggest that the joint venture was in reality a hedge fund or private equity fund established for investment purposes. They further noted that a banking entity may not use a joint venture to engage in merchant banking activities, because such activities involve acquiring or retaining shares, assets, or ownership interests for the purpose of ultimate resale or disposition of the investment. They also noted that if a banking entity owns 25% or more of the voting securities of the joint venture or otherwise controls the joint venture, the joint venture itself would be a banking entity subject to the prohibitions and other provisions of the Volcker Rule and the Regulations.

a covered fund.[38] An acquisition vehicle that is controlled by a banking entity would itself be a banking entity and would be subject to the prohibitions and other provisions of the Volcker Rule and the Regulations.

Foreign Pension or Retirement Funds

An exclusion from covered fund status is available for a plan, fund, or program providing pension, retirement, or similar benefits that is: (i) organized and administered outside of the United States; (ii) a broad-based plan for employees or citizens, which is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and (iii) established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.[39] This exclusion is similar to the treatment provided to U.S. pension funds as a result of the exclusion from the definition of investment company under the ICA provided by section 3(c)(11) for certain broad-based employee benefit plans.

Insurance Company Separate Accounts

An exclusion from covered fund status is available for an insurance company separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses. This exclusion is intended to accommodate the business of insurance by permitting a banking entity that is an insurance company to continue to provide its customers with a variety of insurance products through separate account structures in accordance with insurance laws, while protecting against the use of separate accounts as a means by which banking entities might take a proprietary or beneficial interest in an account that engages in proprietary trading and thereby evade the requirements of the Volcker Rule.

Bank-Owned Life Insurance Separate Accounts

An exclusion from covered fund status is available for a separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is a beneficiary, provided that no banking entity that purchases the policy: (i) controls the investment decisions regarding the underlying assets or holdings of the separate account; or (ii) participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank-owned life insurance.

Loan Securitizations

Another important change from the proposed rule involves a much more comprehensive exclusion from covered fund status for certain loan securitizations.

Under the Regulations, an asset-backed securities ("ABS") issuer that meets certain specified requirements qualifies for an exclusion from treatment as a covered fund ("Loan Securitization Vehicle").

<u>Permissible assets</u> – the assets that may be held by the Loan Securitization Vehicle are limited to:

- loans;

  Commenters requested that the Agencies provide additional guidance regarding the types of transactions that would qualify for treatment as loans. The Agencies noted that the definition of loan that is contained in the Regulations applies both in the context of the Trading Restrictions in which loans are excluded from the proprietary trading prohibitions and in the context of the Fund Restrictions.

---

[38] An acquisition vehicle that survives a transaction would likely be excluded from the definition of a covered fund under the exclusions for either joint ventures or wholly-owned subsidiaries.

[39] The exclusion for foreign plans would be available for a *bona fide* plan established for the benefit of employees or citizens outside of the United States even if some of the beneficiaries of the fund reside in the United States or subsequently become U.S. residents.

The Regulations define "loan" broadly as "any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative." The Agencies noted that the definition of loan does not specify the type, nature or structure of loans included within the definition, other than by excluding securities and derivatives.

The Agencies indicated that the parties' characterization of an instrument is not dispositive, but ultimately "whether a loan is a security or a derivative for purposes of the loan definition is based on the federal securities laws and the Commodity Exchange Act."[40] They observed that whether a loan is a security under the federal securities laws will depend on the particular facts and circumstances, including the economic terms of the loan. They noted that loans that are structured to provide payments or returns based on, or tied to, the performance of an asset, index, or commodity, or to provide synthetic exposure to the credit of an underlying borrower or an underlying security or index, may be securities or derivatives depending on their terms and the circumstances of their creation, use, and distribution.

- rights or other assets designed to assure the servicing[41] or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset meets the requirements for certain permitted securities;[42]

- certain permitted interest rate or foreign exchange derivatives that, by their written terms, relate directly to the loans, the ABS issued by the issuer, or the contractual rights of other assets held by the issuer, and that actually reduce interest rate and/or foreign exchange risk; and

- special units of beneficial interest and collateral certificates that meet specified requirements.

Impermissible assets – the assets of a Loan Securitization Vehicle may not include any of the following:

- a security, including an ABS, or an interest in an equity or debt security other than permitted securities;

- a derivative, other than a permitted derivative; or

- a commodity forward contract.

---

[40] The reference to "federal securities laws" is telling: while the question of whether a loan is a security is a complicated one, it is clear that the definition of "security" is narrower under the Securities Act and the Exchange Act than it is under the ICA, and therefore that the broad definition of "security" contained in the ICA (which includes instruments such as loans) would not be controlling under the Regulations.

[41] Loan Securitization Vehicles may hold "servicing assets" "to the extent that they arise from the structure of the loan securitization or from the loans supporting a loan securitization." These rights and assets may generally include "related or incidental assets in a loan securitization [which] support or further, and therefore, [are] secondary to the loans held by the securitization vehicle;" they cite as an example "mortgage insurance policies supporting the mortgages in a loan securitization," while noting that those same mortgage insurance policies could not be separately securitized in a vehicle constituting a Loan Securitization Vehicle. This exemption is intended to be "consistent with the definition and treatment of servicing assets in other asset-backed securitization regulations, such as the exemption from the definition of 'investment company' under rule 3a-7 promulgated under the [ICA]."

[42] A Loan Securitization Vehicle may hold securities if those securities are: (i) certain cash equivalents for purposes of the permissible rights and assets that may be held by a Loan Securitization Vehicle; or (ii) securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities. "Cash equivalents" are not further defined in the Regulations, but the Agencies noted their interpretation of "cash equivalents" as "highly liquid short term investments whose maturity corresponds to the securitization's expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities." They also provided an illustrative list of "cash equivalents" that might be held by a loan securitization: "deposits insured by the Federal Deposit Insurance Corporation, certificates of deposit issued by a regulated U.S. financial institution, obligations backed by the full faith and credit of the United States, investments in registered money market funds, and commercial paper."

One implication of the prohibition on holding securities is that Loan Securitization Vehicles may not hold corporate bonds or other securities, including other ABS securities, or synthetic securities if they hope to fall within the "loan securitization" exclusion. In addition, such vehicles need to ensure that any derivatives they are party to meet the permitted derivative requirements.

Qualifying Asset-Backed Commercial Paper Conduits

An issuer of asset-backed commercial paper qualifies for an exclusion from covered fund status if it holds only:

- loans and other assets permissible for a Loan Securitization Vehicle; and
- ABS supported solely by assets that are permissible for a Loan Securitization Vehicle and acquired by the asset-backed commercial paper conduit ("ABCP conduit") as part of an initial issuance, either directly from the issuing entity of the ABS or directly from an underwriter in the distribution of the ABS.

The ABCP conduit may issue only ABS, comprised of a residual interest and securities with a legal maturity of 397 days or less. A regulated liquidity provider must have entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding ABS issued by the ABCP conduit (other than any residual interest) in the event that funds are required to redeem maturing ABS.[43]

Qualifying Covered Bonds

The Regulations provide an exclusion from covered fund treatment for an entity owning or holding a dynamic or fixed pool of loans or other assets permissible for a Loan Securitization Vehicle for the benefit of the holders of covered bonds ("CB Entity"). For purposes of this exclusion, a "covered bond" is:

- a debt obligation issued by an entity that meets the definition of an FBO, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions regarding the permissible assets of a CB Entity; or
- a debt obligation issued by a CB Entity, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the definition of an FBO, provided that the entity is a wholly-owned subsidiary of such FBO.

Small Business Investment Companies and Public Welfare Investment Funds

An exclusion from covered fund status is available for certain public welfare and similar funds. The exclusion is available for an issuer that meets one of the following requirements:

- It is a small business investment company ("SBIC"), as defined in a specified provision of the Small Business Investment Act of 1958, or that has received from the Small Business Administration notice to proceed to qualify for a license as an SBIC, which notice or license has not been revoked; or
- Its business is to make investments that are:
    - designed primarily to promote the public welfare, of the type permitted under a specified provision of the National Bank Act, including the welfare of low- and moderate-income communities; or

[43] A "regulated liquidity provider" means: (i) a depository institution; (ii) a bank holding company, or a subsidiary thereof; (iii) a savings and loan holding company that meets certain requirements; (iv) a foreign bank that is subject to certain supervision requirements; and (v) the United States or a foreign sovereign.

- qualified rehabilitation expenditures with respect to a qualified rehabilitated or certified historic structure.

Registered Investment Companies and Business Development Companies Excluded from Covered Fund Status

The Agencies indicated that it was not their intention for registered investment companies and business development companies ("BDCs") to be covered funds, but acknowledged commenters' concerns that registered investment companies and BDCs could be treated as covered funds as a result of the proposed rule's treatment of all commodity pools as covered funds.

To resolve this issue, the final rule specifically and categorically excludes from the definition of covered fund registered investment companies and issuers that have elected to be regulated as BDCs under the ICA.[44]

In addition, the Agencies recognized that some funds may be created with the express intention of converting them into registered investment companies or BDCs after an initial seeding period, and that these seeding vehicles might meet the definition of covered fund during that initial period. In this regard, the Regulations provide exemptions from covered fund status for an issuer:

- that is formed or operated pursuant to a written plan to become a registered investment company as provided in the compliance plan program requirements of the Regulations and that complies with the requirements of section 18 of the ICA; or

- that is formed and operated pursuant to a written plan to become a BDC as provided in the compliance program requirements of the Regulations and that complies with the requirements of section 61 of the ICA.

In either situation, the written plan must address: (i) the banking entity's determination that the seeding vehicle will become a registered investment company or a BDC; (ii) the period of time during which the vehicle will become a registered investment company or SEC-regulated BDC; and (iii) the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated BDC within the one-year time period specified for an initial seeding investment in a customer covered fund or a permitted securitization covered fund. The Regulations permit the FRB to extend the seeding period for up to two years upon application of the banking entity.

A banking entity that seeds a covered fund for any purpose other than to register it as an investment company or to establish a BDC must comply with the prohibitions and restrictions on covered fund activities under the Regulations. The Agencies will monitor seeding activity for attempts to use this exclusion to evade the Fund Restrictions.

Registered Investment Companies and BDCs as Banking Entities

The final rule's categorical exclusion of registered investment companies and BDCs from possible treatment as covered funds eliminates any Volcker Rule issues regarding the authority of a banking entity to sponsor, invest in, or engage in certain transactions with such entities.

However, no exclusion is provided for registered investment companies or BDCs from the definition of "banking entity." Therefore, if a banking entity is deemed to "control" a registered investment company or BDC, the investment company or BDC will itself be a banking entity. Under FRB precedent, a financial holding company may own less than 25% of a class of voting shares of an investment company and provide investment advisory and other services without being deemed to control the investment company. If it were a banking entity, the registered investment company or BDC would be subject to the Trading Restrictions and Fund Restrictions. These limitations, particularly the proprietary trading prohibition and restrictions, could have significant impacts on the ability of a registered investment company or BDC to pursue its investment strategies.

---

[44] As a separate matter, the final rule sharply narrowed the scope of the commodity pool trigger for covered fund status, in a manner that the Agencies noted would not cause registered investment companies to be treated as covered fund commodity pools.

The Agencies' statement that "a seeding vehicle that will become a registered investment company or SEC-regulated [BDC] would not itself be viewed as violating the requirements of section 13 during the seeding period" so long as the banking entity operates pursuant to the banking entity's compliance plan, could be read to indicate that while a seeding vehicle might fall within the definition of a "banking entity," it would nevertheless not be subject to the Trading Restrictions or Fund Restrictions during its seeding period.

The foregoing language does not, however, extend to newly-formed registered investment companies or SEC-regulated BDCs. Thus, the final rule would appear to significantly limit a banking entity's ability to launch a new registered investment company or BDC, essentially requiring the registered entity to have more than 75% of each of its classes of voting shares owned by persons unaffiliated with the banking entity before it could engage in any proprietary trading activity that would be prohibited for a banking entity under the Regulations.

Issues may also arise where a banking entity that is otherwise unaffiliated with a registered investment company holds interests in more than 25% of any class of voting shares of the registered investment company in connection with investment advisory or fiduciary activities on behalf of its clients, together with its own direct holdings. If such investment advisory or fiduciary holdings were attributed to the banking entity, the otherwise unaffiliated registered investment company could itself be deemed to be a banking entity.

Similar issues regarding banking status may arise for other entities excluded from covered fund status, including foreign public funds.

FDIC-Related Entities

The Regulations provide an exclusion from covered fund status for an issuer that is an entity that is formed by, or on behalf of, the FDIC to dispose of assets acquired in the FDIC's capacity as a conservator or receiver for an insured institution or for a covered financial company under Title II of the DFA.

Other Agency-Designated Entities

Recognizing the difficulty of designing a rule that would exclude every type of fund or entity that does not engage in investment activities contemplated by the Volcker Rule's limitations on private fund or hedge fund investments, the Regulations provide for a process by which the Agencies can jointly determine to exclude other entities from the definition of covered fund. The Agencies indicated that they are working to develop a process through which they would evaluate requests for additional exclusions, and anticipate providing related guidance in the future.

The Agencies considered and determined not to provide an exclusion for several types of entities, including financial market utilities, pass-through REITs, venture capital funds, credit funds, cash management vehicles, cash collateral pools, and municipal securities tender option bond transactions.

Permitted Customer Covered Funds and ABS Covered Funds

Q. Under what circumstances may a banking entity sponsor or invest in a covered fund?

A. Sponsorship or investment is permitted in several situations, including where a covered fund is intended to meet the needs of investment advisory and fiduciary clients of a banking entity, or where an ABS fund does not qualify for the exclusion for Loan Securitization Vehicles.

An important element of the Fund Restrictions portion of the proposed rule was the authority it provided for a banking entity to organize and sponsor a covered fund in connection with providing *bona fide* trust, fiduciary, investment advisory, or commodity trading services to customers ("Customer Fund"). Under the proposed rule, a banking entity could have held up to a 3% ownership interest in a Customer Fund, with a larger investment permitted for a general one-year seeding period.

The final rule generally retained this authority with certain revisions. The final rule was modified to also allow for a banking entity to organize and offer an ABS covered fund ("ABS Fund"), generally subject to many of

the same requirements and restrictions that apply to a Customer Fund. Together, Customer Funds and ABS Funds are referred to as “Section 11 Funds.”

Requirements for Customer Funds

A banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as a sponsor to, a covered fund in connection with directly or indirectly organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, if the following conditions (“Customer Fund Conditions”) are satisfied:

- the banking entity provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

- the covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity, pursuant to a written plan or similar documentation outlining how the banking entity intends to provide advisory or similar services to its customers through organizing and offering the covered fund;

- the banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under a specified provision of the Regulations;

- the banking entity and its affiliates comply with the Fund Transaction Provisions;

- the banking entity and its affiliates do not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the covered fund or any covered fund in which the covered fund invests;

- the covered fund, for corporate, marketing, promotional, or other purposes, does not share the same or similar name with the banking entity or any of its affiliates, and does not use the word “bank” in its name;

- no director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

- the banking entity makes specified disclosures to its prospective and actual investors in the covered fund, and complies with any additional rules of an applicable Agency, as provided by the Volcker Rule, designed to ensure that losses in the covered fund are borne solely by investors in the covered fund and not by the banking entity and its affiliates.

In discussing the parameters of the Customer Fund authority, the Agencies reaffirmed the position they expressed in connection with the proposed rule that a customer relationship need not be a pre-existing one. A banking entity’s plan for a Customer Fund must be credible, and must indicate that the banking entity has conducted reasonable analysis to show that the fund is organized and offered for the purpose of providing *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services to customers of the banking entity (or an affiliate thereof) and not to evade the restrictions of the Volcker Rule.

Requirements for ABS Funds

A banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuer of ABS in connection with, directly or indirectly, organizing such issuer and offering its securities, so long as the banking entity and its affiliates comply with the third through the eighth provisions of the Customer Fund Conditions. Thus, an ABS Fund is not required to have any relationship with a banking entity’s trust, fiduciary, investment advisory, or commodity trading advisory activities.

The risk retention requirements that may be imposed in connection with the regulations to be issued by the FRB, FDIC, OCC, SEC, Department of Housing and Urban Development and Federal Housing Finance Agency under section 941 of the DFA ("Risk Retention Regulations") could exceed the ownership levels that are permissible for a banking entity to hold in a Customer Fund.[45] Accordingly, the Regulations allow a banking entity that is acting as a securitizer under the Risk Retention Regulations, or that is acquiring or retaining an ownership interest in an ABS issuer as required by the Risk Retention Regulations, to hold an ownership interest in amount that does not exceed the amount required to comply with the banking entity's chosen method of compliance with the Risk Retention Regulations.

Underwriting and Market Making in Covered Fund Ownership Interests

A banking entity is authorized to engage in underwriting or market making-related activities in regard to covered fund ownership interests, provided that such activities are conducted in accordance with permitted underwriting and market making-related activities under the Trading Restrictions.

A banking entity must include any ownership interests that it acquires or retains in connection with underwriting or market making-related activities for a particular covered fund in the calculation of the per-fund investment limitations that apply to a Customer Fund or ABS Fund ("Fund Investment Limitation"), if the banking entity: (i) acts as a sponsor, investment adviser, or commodity trading advisor to the covered fund; (ii) otherwise acquires and retains an ownership interest in a Customer Fund; (iii) acquires and retains an ownership interest in an ABS Fund that is a covered fund and the banking entity is either a securitizer or is otherwise acquiring the ownership interest under the Risk Retention Regulations; or (iv) directly or indirectly guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests.[46]

A banking entity must also include the aggregate value of all ownership interests of the banking entity and its affiliates in all Section 11 Funds, as well as interests obtained in connection with underwriting and market making-related activities in regard to any covered funds, in the calculation of the aggregate Section 11 Fund ownership limitation ("Aggregate Fund Investment Limitation") and the deduction from tier 1 capital.

Permissible Investments in Section 11 Funds

A banking entity may make an investment in a Section 11 Fund for either of the following purposes:

- Seeding Investment. Establishing the fund and providing it with sufficient initial equity to permit the fund to attract unaffiliated investors, subject to specified limitations; or

- *De Minimis* Investment. Making and retaining a *de minimis* investment in the fund, subject to specified limitations (*i.e.,* the Fund Investment Limitation).

In the case of a seeding investment, the banking entity and its affiliates:

- must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests in the fund to the Fund Investment Limitation; and

[45] The six agencies recently issued re-proposed regulations to implement section 941 of the DFA. 78 Fed. Reg. 57928 (Sept. 20, 2013).

[46] While section 13(d)(1)(B) of the BHC Act is aimed at assuring that banking entities do not bail out a covered fund, that guarantee restriction is not intended to prohibit a banking entity from entering into or providing liquidity facilities or letters of credit for covered funds. The Agencies noted that restriction would apply to arrangements such as a put of the ownership interest in the covered fund to the banking entity.

- must, no later than one year after the date of establishment of the fund,[47] or such longer period as may be provided by the FRB, conform its ownership interest to the Fund Investment Limitation.[48]

The Fund Investment Limitation for a banking entity and its affiliates is generally 3% of the total number or value of outstanding ownership interests of a Section 11 Fund. A detailed description of how a banking entity's ownership interests in a Section 11 Fund are to be calculated, as well as principles regarding circumstances under which ownership interests will or will not be attributed to a banking entity, are provided.[49]

With regard to an ABS Fund, an investment by a banking entity and its affiliates in an ABS Fund may not exceed 3% of the total fair market value of the ownership interests of the ABS Fund unless a greater percentage is retained by the banking entities and affiliates in compliance with the Risk Retention Regulations, in which case the investment by the banking entity and its affiliates in the ABS Fund may not exceed the amount, number, or value of ownership interests of the ABS Fund required under the Risk Retention Regulations.

The Aggregate Fund Investment Limitation provides that the aggregate value of all ownership interests of the banking entity and its affiliates acquired or retained in all Section 11 Funds may not exceed 3% of the tier 1 capital of the banking entity, calculated as of the last day of each calendar quarter. The aggregate value of all ownership interests held by a banking entity is the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds, on a historical cost basis.[50]

A banking entity is required to deduct the aggregate amount of all investments in covered funds from the banking entity's tier 1 capital. For purposes of determining the amount of the deduction, the Regulations require the banking entity to use the greater of: the historical cost plus any earnings received; or the fair market value of banking entity's ownership interests in the covered fund if the banking entity accounts for profits or losses of the fund investment in its financial statements.

Other Permitted Covered Funds

As discussed above, an important change from the proposed rule was the decision by the Agencies to provide a series of exclusions from covered fund status as compared to treating entities as covered funds as to which certain relationships would be permitted. The remaining types of permitted covered funds are discussed below.

Permitted Risk-Mitigating Hedging Activities

A banking entity is permitted to hold an ownership interest in a covered fund where the interest is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity

---

[47] The date of establishment of a fund is the date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund. In the case of an ABS Fund, the establishment date is the date on which assets are initially transferred into the issuing entity of the ABS.

[48] The FRB may extend this time period for up to two additional years, if it finds that an extension would be consistent with safety and soundness and not detrimental to the public interest.

[49] The proposed rule provided that, to the extent a banking entity is contractually obligated to invest in, or is found to be acting in concert through knowing participation in a joint activity or parallel action toward a common goal of investing in, one or more investments with a covered fund that is organized and offered by the banking entity (whether or not pursuant to an express agreement), such investment must be included in the calculation of the banking entity's Fund Investment Limitation. The Agencies determined to not include this provision in the final rule. They did indicate that they continued to believe that there is a potential for evasion where a banking entity coordinates its direct investment decisions with the investments of a covered funds it owns or sponsors. In that regard, they described certain circumstances under which limitations would apply to the combination of investments made by a covered fund and a banking entity.

[50] The Regulations describe how tier 1 capital will be calculated, as well as how foreign banking entities will be treated.

in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof who directly provides investment advisory, commodity trading advisory or other services to the covered fund. The Regulations establish certain requirements for a permissible risk-mitigating hedging covered fund investment.

Permitted Non-U.S. Covered Fund Activities and Investments by Foreign Banking Entities with a Foreign Entity Ultimate Parent

The Regulations permit a foreign banking entity with an ultimate parent entity that is not organized under U.S. law, and which meets certain requirements, to sponsor or hold ownership interests in a covered fund outside of the United States. The foreign banking entity must meet certain requirements in regard to its activities, as discussed above in regard to permissible non-U.S. proprietary trading by foreign banking entities.

Among other requirements, that exemption is available only if no ownership interest in the covered fund is offered for sale or sold to a resident of the United States. The Regulations provide that an ownership interest in a covered fund will be deemed to not be offered or sold to a resident of the United States if it is sold or has been sold pursuant to an offering that does not target residents of the United States. In a change from the proposed rule, the term “resident of the U.S.” is defined by reference to a person that is a “U.S. person” as defined in rule 902(k) of the SEC’s Regulation S.

In addition, the activity or investment must occur outside of the United States. This requirement will be satisfied only if:

- the banking entity acting as a sponsor, or acting as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under U. S. law;
- the banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under U.S. law;
- the investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal, directly or indirectly, by any branch or affiliate that is located in the United States or organized under U.S. law; and
- no financing for the banking entity’s ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under U.S. law.

For these purposes, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States. A foreign bank of which that branch, agency, or subsidiary is part, is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

Permitted Covered Fund Investments and Activities by a Regulated Insurance Company

The proposed rule provided exceptions to the proprietary trading restrictions for trading by insurance companies in their general or separate accounts, but did not extend these exceptions to covered fund interests and activities. In response to comments, the final rule extended special treatment to insurance companies’ covered fund interests and activities.

The general prohibitions on covered fund investments and relationships do not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund, only if:

- the insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

- the acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company laws, regulations and written guidance of an applicable state or other jurisdiction in which the insurance company is domiciled; and

- the appropriate federal banking agencies, after consultation with the FSOC and the relevant insurance commissioners of the states and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.

Fund Transaction Provisions

Q. What restrictions apply to transactions between a covered fund and a banking entity that sponsors, invests in, or provides investment advisory or commodity trading advisory services to the covered fund?

A. The Volcker Rule imposes certain prohibitions and restrictions on transactions and relationships involving banking entities and covered funds. This is done by drawing on concepts found in section 23A of the FRA ("Section 23A") and section 23B of the FRA ("Section 23B") and modifying them to apply in the context of covered funds.

Super 23A Prohibitions

The Volcker Rule prohibits a banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, that organizes and offers a Section 11 Fund, or that continues to hold an ownership interest in a Section 11 Fund, and any affiliate of such banking entity, from entering into a transaction with the covered fund, that would be a "covered transaction"[51] under Section 23A, as if such banking entity or affiliate thereof were a member bank and the covered fund were an affiliate thereof.

This provision is generally referred to as the Super 23A prohibition since it entirely prohibits covered transactions, rather than placing qualitative and quantitative restrictions on them as provided in Section 23A of the FRA. It is important to note that the Super 23A prohibitions apply not only to banking entities that sponsor, or invest in, a covered fund, but also to banking entities that merely act as an investment manager or investment adviser to a covered fund.

Notwithstanding the general prohibition of banking entities and affiliates engaging in covered transactions, a banking entity may acquire or retain an ownership interest in a Section 11 Fund or another permitted covered fund as permitted under the Regulations.

The Regulations also implement a provision in the Volcker Rule that permits a banking entity or an affiliate to enter into any prime brokerage transaction[52] with a covered fund managed, sponsored, or advised by such banking entity or affiliate thereof or in which a banking entity or affiliate has taken an ownership interest, if:

---

[51] The Agencies summarized the term "covered transaction" for purposes of Section 23A to mean with respect to an affiliate of a member bank: (i) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase; (ii) a purchase of or an investment in securities issued by the affiliate; (iii) a purchase of assets from the affiliate, except such purchase of real and personal property as may be specifically exempted by the FRB by order or regulation; (iv) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (v) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (vi) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or subsidiary to have credit exposure to the affiliate; or (vii) a derivative transaction, as defined in paragraph (3) of section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)), with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate.

[52] A "prime brokerage transaction" means any transaction that would be a covered transaction that is provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, or financing, data, operational, and portfolio management support.

- the banking entity is in compliance with the limitations set forth in regard to a Section 11 Fund with respect to a covered fund organized and offered by the banking entity or an affiliate thereof;

- the CEO or equivalent officer of the banking entity certifies in writing annually to the applicable Agency (with a duty to update this as information materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or any other covered fund in which such covered fund invests; and

- the FRB has not determined that the prime brokerage transaction would be inconsistent with the safe and sound operation and condition of the banking entity.

All prime brokerage transactions with a covered fund will be subject to the requirements of Section 23B as if the covered fund were an affiliate.

Section 23B Requirements

The Volcker Rule provides that the requirements imposed on certain transactions under Section 23B will apply to a banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to covered fund, or that organizes and offers a Section 11 Fund, or that continues to hold an ownership interest in accordance with the provisions regarding ownership interests in an ABS Fund, as if such banking entity were a member bank and the covered fund was an affiliate thereof. Section 23B generally requires that certain transactions between member banks and affiliates must be on terms and under circumstances that are substantially the same or at least as favorable to the banking entity as those prevailing at the time for comparable transactions with or involving unaffiliated companies, or in the absence of comparable of transactions, on terms and under circumstances that in good faith would be offered to an unaffiliated party.

Overriding Prohibitions on Permissible Covered Fund Activities

Q. What other limitations apply to permitted covered fund activities?

A. The same overriding restrictions that apply to permitted proprietary trading activities apply to permitted covered fund activities.

The Fund Restrictions portion of the Regulations sets forth a parallel set of provisions to the Trading Restrictions that provide that no transaction, class of transaction, or activity that is deemed a permissible covered fund activity will be permissible if it involves material conflicts of interest that are not adequately addressed by timely and effective disclosure or information barriers, involves material exposure by a banking entity to a high-risk asset or a high-risk trading strategy, or poses a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

COMPLIANCE PROGRAM REQUIREMENTS

Q. What compliance-related obligations do the Regulations impose on banking entities?

A. A general compliance program requirement has been created for banking entities, which must include specified elements. In certain circumstances, banking entities will be subject to enhanced compliance program requirements. In other circumstances, their obligations may be more limited.

Each banking entity must develop and implement a program that is reasonably designed to ensure and monitor compliance with the Volcker Rule and the Regulations. As a general matter, the compliance program must, at a minimum, include the following elements:

- written policies and procedures to document, describe, monitor and limit trading activities subject to the Trading Restrictions (including permitted proprietary trading activities) and activities and investments subject to the Fund Restrictions (including permitted covered fund

activities and investments) to ensure that the activities and investments conducted by the banking entity comply with the Volcker Rule and the Regulations;

- a system of internal controls reasonably designed to monitor compliance with the Volcker Rule and the Regulations and to prevent prohibited activities and investments;

- a management framework that clearly delineates responsibility and accountability for compliance with the Volcker Rule and the Regulations and that includes: appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters as identified by the Regulations or management as requiring attention; and independent testing and audit for the effectiveness of the compliance program conducted by qualified personnel of the banking entity or by a qualified outside party;

- training for trading personnel, managers, and other appropriate personnel, to effectively implement and enforce the compliance program; and

- records sufficient to demonstrate compliance with the Volcker Rule, which must be promptly provided to the relevant Agency upon request and retained for a period of no less than five years or such longer period as required by the relevant Agency.

Enhanced compliance program requirements set forth in Appendix B to the Regulations apply to a banking entity if it falls into one of three categories:

- it is engaged in proprietary trading and is required to report metrics regarding its trading activities to its primary federal supervisory agency;

- it has reported total consolidated assets of $50 billion or more as of the previous calendar year-end, or, in the case of a foreign banking entity, has total U.S. assets of $50 billion or more as of the previous calendar year end; or

- it is notified by its primary federal supervisory agency in writing that it is required to meet the requirements and other standards contained in Appendix B.

Appendix B provides that an enhanced compliance program must:

- be reasonably designed to identify, document, monitor and report covered trading and covered fund activities; identify, monitor and promptly address risks of these covered activities and investments and potential areas of noncompliance; and prevent activities and investments prohibited by, or that do not comply with, the Volcker Rule and the Regulations;

- establish and enforce appropriate limits on the covered activities and investments of the banking entity;

- call for the conduct of periodic independent review and testing of the compliance program to ensure that the entity's internal audit, corporate compliance and internal controls are effective and independent;

- make senior management, and others as appropriate, accountable for the effective implementation of the compliance program and ensure that the board of directors and the CEO (or equivalent) review the effectiveness of the compliance program; and

- facilitate the supervision and examination by the Agencies of covered trading and covered fund activities and investments.

Banking entities that engage in proprietary trading activities exceeding certain thresholds are required to satisfy reporting requirements set forth in Appendix A to the Regulations. Banking entities that exceed a specified asset threshold must maintain certain records in regard to their covered fund-related activities.

A banking entity that does not engage in proprietary trading (other than permitted trading in U.S. government and related obligations) or covered fund activities may satisfy its compliance program requirements by

establishing the required compliance program before becoming engaged in such activities or making such investments (other than permitted trading in U.S. government and related obligations).

A banking entity with total consolidated assets of $10 billion or less as of the two most recent calendar year-ends that engages in proprietary trading or covered fund activities may satisfy the compliance plan requirements by including in its existing compliance policies and procedures appropriate references to the requirements of the Volcker Rule and the Regulations with adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

ENFORCEMENT

A banking entity that engages in an activity or makes an investment in violation of the Volcker Rule and the Regulations or acts in a manner that functions as an evasion of those requirements must, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment. If an Agency finds reasonable cause to believe any banking entity has engaged in an impermissible activity or investment, the Agency may take any action permitted by law to enforce compliance with the Volcker Rule and the Regulations, including directing the banking entity to restrict, limit or terminate any or all activities under the Regulations, and dispose of any investment.

This update was authored by the lawyers listed below.

Robert H. Ledig
Washington, D.C.
+1 202 261 3454
robert.ledig@dechert.com

Corey Rose
Charlotte
+1 704 339 3164
corey.rose@dechert.com

Thomas P. Vartanian
Washington, D.C.
+1 202 261 3439
thomas.vartanian@dechert.com

David L. Ansell
Washington, DC
+1 202 261 3433
david.ansell@dechert.com

David J. Harris
Washington, DC
+1 202 261 3385
david.harris@dechert.com

Matthew K. Kerfoot
New York
+1 212 641 5694
matthew.kerfoot@dechert.com

Jeremy I. Senderowicz
New York
+1 212 641 5669
jeremy.senderowicz@dechert.com

John M. Timperio
Charlotte
+1 704 339 3180
john.timperio@dechert.com

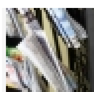
David A. Vaughan
Washington
+1 202 261 3355
david.vaughan@dechert.com

M. Holland West
New York
+1 212 698 3527
holland.west@dechert.com

Cynthia J. Williams
Boston
+1 617 654 8604
cindy.williams@dechert.com

Christopher Desmond
Boston
+1 617 728 7170
christopher.desmond@dechert.com

The authors would like to thank Matthew Barsamian for his contributions to this OnPoint.



To browse our library of legal updates, please visit http://www.dechert.com/publications/.

Dechert's Financial Services Group has approximately 160 lawyers across the United States, Europe, Asia and the Middle East. For more information and to see the full list of lawyers, please visit our website at http://www.dechert.com/financial_services/.

© 2014 Dechert LLP. All rights reserved. This publication should not be considered as legal opinions on specific facts or as a substitute for legal counsel. It is provided by Dechert LLP as a general informational service and may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome. We can be reached at the following postal addresses: in the US: 1095 Avenue of the Americas, New York, NY 10036-6797 (+1 212 698 3500); in Hong Kong: 27/F Henley Building, 5 Queen's Road Central, Hong Kong (+852 3518 4700); and in the UK: 160 Queen Victoria Street, London EC4V 4QQ (+44 20 7184 7000).

Dechert internationally is a combination of separate limited liability partnerships and other entities registered in different jurisdictions. Dechert has more than 800 qualified lawyers and 700 staff members in its offices in Belgium, China, France, Germany, Georgia, Hong Kong, Ireland, Kazakhstan, Luxembourg, Russia, the United Arab Emirates, the UK and the US. Further details of these partnerships and entities can be found at www.dechert.com on our Legal Notices page.

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.